SUPREME COURT, U. S.

Nos. 797, 804, 808, 809

IN THE

Supreme Court of the United States

October Term, 1967

AMERICAN COMMERCIAL LINES, INC., et al.,
Appellants in No. 797

AMERICAN TRUCKING ASSOCIATIONS, INC., et al.,
Appellants in No. 804

THE AMERICAN WATERWAYS OPERATORS, INC.,
Appellant in No. 808

INTERSTATE COMMERCE COMMISSION,
Appellant in No. 809

v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, et al.,
Appellees

On Appeal From the United States District Court for the Western District of Kentucky.

BRIEF FOR RAILROAD APPELLEES

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INTERSTATE COMMERCE COMMISSION,
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v.

LOUISVILLE AND NASHVILLE RAILROAD COMPANY, et al.,
Appellees

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF KENTUCKY

BRIEF FOR RAILROAD APPELLEES [1]

1. The list of the Railroad appellees is found at A. 1-2.

I

THE QUESTIONS

1. Whether, in view of Section 15a(3) of the Interstate Commerce Act and the National Transportation Policy, the court below was right in holding that normally where reduced intermodal competitive rates are before the Interstate Commerce Commission, they should be approved if they exceed the proponent mode's out-of-pocket costs and are not detrimental to such mode's own revenue requirements?

2. Whether the court below was right in holding that in *Ingot Molds, Pa., to Steelton, Ky.*, 326 I.C.C. 77 (1965), the Commission's decision was without a rational basis and therefore arbitrary?

II

STATEMENT

This brief will answer the four briefs of the several appellants. While each of these briefs states the facts before this Court in somewhat different fashion, the facts, as such, are not in dispute. They are best summarized by the court below at the outset of its opinion.[2] But to give these facts added meaning, attention is invited to several of their significant features.

First, the Interstate Commerce Commission found that the reduced rail rate of $5.11 per gross ton on ingot molds is required by the railroads if they are to effectively compete for the traffic.[3]

Second, the reduced rail rate has found to be compensatory by the Commission since it exceeds the railroads' out-of-pocket costs as computed by the Commission's own Rail Form A formula[4] by 42.1 cents a ton.[5] A word or so

2. Louisville and Nashville Railroad v. United States, 268 F. Supp. 71, 73-75 (W.D. Ky. 1967); A. 12-16.

3. Ingot Molds, Pa., to Steelton, Ky., 326 I.C.C. 77, 78 (1965); A. 61-62.

4. Rail Form A is a formula developed and refined over the years by the Cost Finding Section of the Interstate Commerce Commission. One of its principal purposes is the determination of the costs incurred in providing a particular rail freight service. See EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO THE USE OF COSTS—STATEMENT NO. 7-63 OF I.C.C. COST FINDING SECTION at 3 (1963). Similar formulas have been developed by the Cost Finding Section to compute the costs of motor and water carrier services. EXPLANATION OF THE DEVELOPMENT OF MOTOR CARRIER COSTS—STATEMENT NO. 4-59 OF I.C.C. COST FINDING SECTION (1959); FORMULA FOR DETERMINING COST OF TRANSPORTING FREIGHT BY BARGE LINES—STATEMENT NO. 6-62 OF I.C.C. COST FINDING SECTION (1964).

5. 326 I.C.C. at 78, 79; A. 62-63.

about this most significant, but somewhat misleading terminology. The term out-of-pocket costs, sometimes spoken of interchangeably with such terms as variable costs or incremental costs, as used in connection with Rail Form A, reflects "the added costs which [are] . . . incurred because the traffic in question [is] . . . handled or the costs which could [be] . . . avoided if the traffic [is] . . . not handled." Stated differently, out-of-pocket costs, as computed by Rail Form A, include all of the expenses occasioned by the rendition of a particular service. They include not only the direct expenses for labor, material, equipment and supervision, but assigned portions of overhead items, such as accounting expenses, executives' salaries and taxes. Often lost sight of, they also include 100 percent of the return on the depreciated investment in equipment and 50 percent of the return on the depreciated investment in roadway property.[6] Since the out-of-pocket costs reflect the costs incurred in rendering a particular service,[7] they are universally used by the Commission in determining whether any particular rate will produce revenues which are compensatory.[8]

Entirely apart from the expenses incurred by the railroads, or by any other mode, in furnishing an individual

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6. See Reduced Transcontinental Lumber Rates, 1961, 318 I.C.C. 815, 840-841 (1963); EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO USE OF COSTS, I.C.C. COST FINDING SECTION STATEMENT No. 7-63 at 1-3 (1963). Since the out-of-pocket expenses include substantial amounts for return on investment, in many instances they overstate the actual expenses incurred in rendering a particular service. See FRIENDLY, *The Federal Administrative Agencies: The Need For Better Definition of Standards*, 75 Harv. L. Rev. 1263, 1271 (1962). This is true in Ingot Molds. See A. 143, 150.

7. See Chicago & N.W. Ry. v. Atchison, T. & S.F. Ry., 378 U.S. 326, 333-334.

8. Dairy Products From Twin Cities to Chicago, 321 I.C.C. 720, 724 (1964) Cement Within Southern Terr. & From Hagerstown to So., 319 I.C.C. 465, 478 (1963).

service such as the movement of ingot molds, there are other expenses which the enterprise as a whole must bear. These are the so-called constant expenses.

Constant expenses are those arising from facilities and activities which exist and must be maintained regardless of the amount of business conducted, or in fact whether any business is done. A typical example is the stone or steel railroad bridge across a river or the fencing along a railroad's rights-of-way. The expenses arising from such items exist and must be borne regardless of how much traffic goes over the bridge or past the fence. Adding new services or extending existing services does not increase such expenses. Included in the so-called constant expenses of the railroads are the deficits which regularly recur from the rendition of passenger services.

By their nature, since they are not occasioned by the rendition of any particular service, constant expenses cannot be assigned to any service except upon an arbitrary basis. This is not to say that the constant expenses do not have to be recovered. They must be if the enterprise is to remain viable. Whether they are recovered depends entirely upon whether the revenues in excess of the out-of-pocket costs generated from each item of traffic, in the aggregate will be sufficient to meet them. If the contribution to the constant expenses from each item of traffic is maximum by reason of the rate charged and the volume of business generated, the enterprise can do nothing more to cover its constant expenses.

With respect to the ingot molds rate, the Commission found that it would make a maximum contribution towards the railroads' constant expenses[9] and that therefore the railroads would be better off with the reduction than with-

9. 326 I.C.C. at 82; A. 67.

out it. This reduced rate therefore, far from being detrimental to the railroads' needs, is most constructive and helpful.

"Fully-distributed cost," when applied to a particular service, is economically and practically speaking, a poorly descriptive label. It is a composite number comprised of the ascertainable out-of-pocket costs of providing the particular service plus an arbitrary assignment of some portion of the total constant expenses.[10] The resulting number is thus partly cost and partly a hoped-for contribution towards the enterprise's constant costs.

These concepts just discussed are elementary and fundamental principles of economics, more fully explained by the economic testimony which was presented by the railroads and, to a large extent, ignored by the Commission.[11]

A third aspect of the facts should also be highlighted. Nowhere in the Commission's reports is there any finding to the effect that the reduced ingot molds rate is unlawful if judged by standards regularly and ordinarily applied where reduced carrier pricing is before the Commission. There is no finding, for example, this rate is discriminatory among shippers, prejudicial to locations, in violation of the long and short haul provision, predatory in the sense that it is aimed at the destruction of a competitor or involves unfair pricing practices. In fact this ingot molds rate has characteristics shared by an almost limitless number of rail and other carrier rates. Throughout the pricing structures of all modes, there are rates aimed at generating traffic in the face of competition, which are established above the out-of-pocket level but well below the artificial fully-distributed

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10. See Chicago & N.W. Ry. v. Atchison, T. & S.F. Ry., *supra*, n. 7 at 334; EXPLANATION OF RAIL COST FINDING PROCEDURES, *supra*, n. 6 at 1-6, 24-26.

11. See *e.g.*, A. 84-88, 91-95, 112-114, 118-119, 124, 130, 133, 140-141, 145, 158-159.

cost number. The appellants themselves state this to be the case.[12]

The Commission's sole basis for ordering the cancellation of the railroads' constructive pricing adjustment, which affords the shipper a choice of two competitive services at the same charge, is its conclusion that the railroads have "unlawfully impinged upon the ability of the barge-truck route competitively to assert its inherent cost advantage."[13] In addition, the Commission indicates that the ingot molds rate will only be allowed if it is raised, not to the level of any cost floor of the railroads but to the "fully-distributed cost" figure which it found applicable to the barge-truck route.

The court below, reviewing this anticompetitive result, which insures the barge-truck route of a monopoly of this particular traffic, concluded the Commission had not set forth a rational basis for its actions, and further, such actions were inconsistent with the relevant statutory standards interpreted in the light of their legislative histories.

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12. Some 65 percent of rail tonnage moves at rates below "fully-distributeld cost" A. 155. See brief of American Commercial Lines at 35-37.

13. 326 I.C.C. at 85; A. 71.

III

SUMMARY OF ARGUMENT

The court below has interpreted correctly the statutory standards for reduced intermodal competitive rates by holding that the Congress, by the enactment of the National Transportation Policy and Section 15a(3) of the Interstate Commerce Act, evidenced an "intent that reduced compensatory rates should normally be allowed." This interpretation has ample support in the legislative histories of the relevant statutory provisions.

The National Transportation Policy, which requires the Commission to "recognize and preserve the inherent advantages of each [mode]" is the preamble to the contemporary Interstate Commerce Act and is specifically an integral part of Section 15a(3) which contains the rule of ratemaking for reduced intermodal competitive rates. This policy, in its present form, was enacted as part of the Transportation Act of 1940. Its mandates, including the requirement that inherent advantages be recognized and preserved, reflect an earlier Policy statement which was applicable to the Motor Carrier Act of 1935.

The legislative history of the National Transportation Policy indicates that the objective was to require the Commission, in judging the lawfulness of the rates of any mode to do so with regard to such mode's own costs and transportation characteristics, rather than those of another competitive mode.

In *New Automobiles in Interstate Commerce,* 259 I.C.C. 475 (1945), the Commission made an exhaustive review of the legislative history of the National Transportation Policy and the then new rule of ratemaking contained in Section 15a(2) to determine the extent of its powers where one mode reduces its rates to respond to

the competition of another. The Commission concluded that the recognition and preservation of inherent advantages would be best accomplished by permitting each mode to reduce its rates to meet competition provided the reductions would be compensatory. For a rate to be compensatory, the Commission said it would have to exceed the proponent mode's own out-of-pocket costs. By adopting this cost standard, the Commission not only concluded that each of the several modes would be able to price its services to reflect its own inherent advantages but that the public would also benefit from the lower transportation charges brought about by effective competition.

By the enactment in 1958 of Section 15a(3), Congress intended to insure Commission adherence to the philosophy of *New Automobiles* from which it had deviated during the 1945-1958 period. *New Automobiles* supports the interpretation of Section 15a(3) of the court below because it stands squarely for the proposition that normally reduced intermode competitive rates should be approved if they are compensatory and not detrimental to the proponent mode's own revenue needs.

The use of "fully-distributed cost" floors, whether reflecting those of the proponent or competitive mode, as a device for recognizing or preserving inherent advantages, finds no support in the legislative histories of any of the relevant statutory provisions. Rather, the legislative history of the Transportation Act of 1940 provides a strong basis for the contrary view that "fully-distributed costs" should not be used as a rate floor. Congress, in its extended consideration of the powers the Commission should be given in determining the reasonableness of intermodal rate reductions, specifically rejected proposals which would have established "fully-distributed costs" as rate floors. Later, in 1958, it likewise rejected similar proposals in its consideration of Section 15a(3).

While the court below held that normally reduced rates should be allowed if compensatory, it plainly stated that its interpretation of Section 15a(3) is not an inflexible one. Deviations from the normal rule are permitted, the court below said, provided the Commission has a rational basis for doing so.

In *Ingot Molds,* the Commission, although it found: the railroads' reduced rate compensatory; not detrimental —but actually beneficial—to the railroads' revenue needs; and required for effective competition, concluded that the reduction was unlawful because it "impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage." The Commission further concluded that the reduced rail rate could only be lawfully maintained if it were substantially increased so as to exceed the "fully-distributed cost" level of the barge-truck route. By so doing, the Commission has required reduced railroad pricing not to reflect railroad costs but those of another mode. And it did this despite the presence of uncontroverted testimony to the effect that elementary and fundamental economic principles require a conclusion that inherent advantages will be best recognized and preserved by establishing as a floor for reduced rates the proponent mode's own out-of-pocket costs and that there is no justification for using "fully-distributed cost" floors—and particularly those of another mode—for such purposes.

The only justification given by the Commission for its approach which establishes artificial restraints upon free and fair competition is that it has done so before. But in none of the earlier cases relied upon is there any rationale given for the use of "fully-distributed cost" floors. And as the court below points out, the Commission in this area has evidenced the greatest inconsistency, and has frequently permitted reduced rates upon a showing that

they are compensatory and responsive to intermodal competitive urgings.

The court below held that the Commission's report contains no rational basis for the perfunctory conclusions reached and that therefore it is arbitrary and must be set aside. While the appellants take issue with this holding, it seems apparent that they also feel the Commission's actions lack a rational basis. This is evidenced by their attempts to provide a *post hoc* rationalization for the Commission's conclusions.

The *Chenery* doctrine requires the Commission's actions to be judged upon what its report contains and not upon after supplied reasons and rationalizations, and therefore the appellants newly conceived rationale, first presented before this Court, should fail. But assuming, for argument purposes only, that this new rationale is properly presented here, it must nevertheless fail because it is wholly lacking in substantive merit.

The appellants contend that only by utilizing fully-distributed costs, both as the measure of inherent advantages and as a floor to preserve such advantages, can recognition be given to the fact that motor and water carriers have the "inherent" or "natural" advantage of using Government supplied rights-of-way, either free or without the payment of adequate user charges, and that by contrast the railroads must pay for their rights-of-way out of their own pockets. This contention is wrong because the cost formulas developed by the Commission for determining out-of-pocket costs give full recognition to this situation regardless of its obvious unfairness and inequity. The out-of-pocket costs developed by the use of the Commission's own formula for the barge-truck route in *Ingot Molds*, include no expense items to cover the costs of the Government in supplying rights-of-way to the barges and the trucks. Therefore, the "advantage" of the barges and

the trucks in using Government supplied facilities free, or for inadequate user charges, is given complete recognition when their own out-of-pocket costs are used as the floor for their rates.

By startling contrast, the out-of-pocket costs of the railroads in providing the ingot molds service—as computed by the Commission's formula—include all of the railroads' right-of-way expenses which the Commission regards as being incurred in providing such service, plus a substantial return on the investment in the roadway facilities. Thus, the use of the railroads' out-of-pocket costs as the floor for reduced rail rates gives full recognition to the disabilities the railroads must bear in paying for their own rights-of-way.

What the appellants, by advocating the use of "fully-distributed cost" floors, are seeking is not the recognition and preservation of inherent advantages, but the establishment of artificial and uneconomic pricing restraints which will deny the railroads the right to enjoy their inherent cost advantage and to thereby compete effectively with other modes. And, more importantly, the position of the appellants will deprive the public of the benefits of competition in the form of lower transportation charges.

IV

ARGUMENT

The court below, in its opinion, first directs its attention to the claim that the Commission's order lacks a rational basis and therefore constitutes arbitrary action which a reviewing court should set aside under the Administrative Procedure Act.[14] None of the appellants quarrels with the right of the reviewing court to set aside administrative agency action, if in fact it lacks a rational basis. But in each of the four briefs it is claimed that the Court below has erred in holding that the required rational basis is not present.[15]

It appears that each of the appellants is less concerned with the holding of the court in this area than with its second holding that the "Commission's order is based upon a "misinterpretation or misapplication of the relevant statutory provisions" and ". . . is therefore not in accordance with law."[16] Each of the appellants' briefs directs its first and most important efforts to show error in this holding.

Although the railroad appellees believe either basis advanced by the court below alone is sufficient to require affirmance of its judgment that the order of the Commission be set aside; and that the questions were dealt with in the proper sequence below, to facilitate argument here the appellants' contentions will be answered in the order presented.

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14. 268 F. Supp. at 75; A. 16-17, 5 U.S.C. §§ 1001-1011.

15. Briefs of Commission at 40-50, American Commercial Lines at 39-55, American Trucking Associations at 20-25, American Waterways Operators at 12-18.

16. 268 F. Supp. at 79, 82; A. 25, 31.

A. The Court Below Correctly Held Congress Has Evidenced an Intention That Normally, in Intermodal Competitive Situations, Carriers Should be Free to Compete for Traffic by Compensatory Pricing Reductions Which Are Not Detrimental to Their Own Revenue Requirements

After an exhaustive review of the legislative history of Section 15a(3) of the Interstate Commerce Act, which contains the statutory standards for judging the lawfulness of reduced intermodal competitive rates, and of the Transportation Act of 1940,[17] which brought into effect both the National Transportation Policy and the rule of rate-making found in Section 15a(2)[18] which was refined by the enactment of Section 15a(3), the court below reached this conclusion:

> We believe that the Commission failed to take adequate account of the Congressional intent that carriers should normally be free to offer rates which are compensatory, i.e., above relevant out-of-pocket costs . . .
>
> We do not mean to suggest that there may not be situations where the Commission has power, under Section 15a(3) and the National Transportation Policy, to prohibit reduced rates even though they are compensatory. What we do suggest is that Congress has expressed a clear intent that reduced compensatory rates should normally be allowed and that the record here and the Commission's report supply no basis for disregarding that intent.[19]

The appellants, differing among themselves as to the reasons, argue that this conclusion is wrong. The Com-

17. 54 Stat. 899-956.
18. 49 U.S.C. § 15(a) 2.
19. 268 F. Supp. at 82-83; A. 31-32.

mission and American Commercial Lines take the position that the Court's interpretation lays down an excessively rigid rule of law which seriously interferes with, or may even destroy, the Commissions' power to preserve inherent advantages.[20] American Trucking Associations contends that the conclusion is not supported by the bases set forth.[21] American Waterways Operators seems to take the position that the conclusion of the court below regarding the purpose of Section 15a(3) is wrong because it does not protect the water carriers from "out-of-pocket competitive ratemaking" and infers that the purpose of the Congress was to outlaw such pricing.[22]

From the language of the court below, it is apparent that it did not intend to withhold from the Commission jurisdiction to review intermodal pricing reductions to determine whether they will destroy the inherent advantages of another mode. But the court did say that before the Commission should condemn a reduction which would not be detrimental to the proponent mode's own revenue requirements and which would afford the shipping public the benefits of competition in the form of lower charges, it should have strong and well articulated reasons for doing so. Such reasons, it said, are not found in the Commission's report. In reaching this conclusion, supported by its review of the legisative histories of the controlling statutory standards, the court below was expressing the same thought as this Court had reached upon its own review of the legislative history of Section 15a(3) in *New Haven*.[23] This Court there said:

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20. Briefs of Commission at 12-13, American Commercial Lines at 11-15.

21. Brief of American Trucking Associations at 7-20.

22. Brief of American Waterways at 10-16.

23. I.C.C. v. New York, N.H. & H. R.R., 372 U.S. 744.

> If a carrier is prohibited from establishing a reduced rate that is not detrimental to its own revenue requirements merely because the rate will divert traffic from others, then the carrier is thwarted from asserting its own inherent advantages of cost and service. (372 U.S. at 759)

Since a reduced rate which is above out-of-pocket costs is compensatory, it will be beneficial to the proponent mode's revenue requirements if, by reason of the traffic volume it generates, the aggregate amount realized above the out-of-pocket costs exceeds that from its previous higher rate. Here, as the Commission found, the reduced ingot molds rate, by attracting traffic, will increase the contribution to the railroads' constant expenses and therefore is precisely the type of enjoyment of inherent advantage which this Court, in *New Haven*, indicated the legislative history of Section 15a(3) approves.

The court below, upon its own review of the legislative history, reached the identical conclusion of this Court in *New Haven*, that Section 15a(3) "was designed to reaffirm the intent of the 1940 Act, an intent that had been correctly construed by the Commission in 1945 in *New Automobiles in Interstate Commerce*, 259 I.C.C. 475, but which in the Committee's view, had not been consistently followed."[24] The lower court's language was only slightly different.[25]

The court below was also impressed with the fact that in *New Automobiles* the Commission had found that a compensatory rate is one which exceeds out-of-pocket costs, and that such rates normally should be allowed so that the public would have the benefit of for-hire transportation at rates reduced in response to the urgings of intermodal competition.[26]

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24. 372 U.S. at 756.
25. 268 F. Supp. at 80, 82; A. 26, 31.
26. 268 F. Supp. at 81-82; A. 29-30.

To have supported its position, the court below could have quoted from the Commission's own finding in *New Automobiles:*

> A reasonably compensatory rate is one which is remunerative, i.e., covers the out-of-pocket costs, as hereinbefore defined, of handling the particular traffic under consideration, including a proper return on investment . . .
>
> As Congress enacted separately stated rate-making rules for each transport agency, it obviously intended that the rates of each such agency should be determined by us in each case according to the facts and circumstances attending the movement of the traffic by that agency. In other words, there appears no warrant for believing that rail rates, for example, should be held up to a particular level to preserve a motor-rate structure, or vice versa.
>
> It is obvious that rate reductions cannot be halted by the prescription of minimum rates unless the existing rates have fallen below a reasonable minimum level. According to the cost studies the rates of the several forms of transportation are generally compensatory, except in scattered instances. Within reasonable limits the public is entitled to the reduced rates brought by competition. (259 I.C.C. at 538-539)

The court below might further have pointed out that the Commission, in *New Automobiles,* in reaching the conclusion that—under the National Transportation Policy and the then new rule of ratemaking in the Transportation Act of 1940—compensatory rates normally should not be interfered with, made a detailed examination of the extent of its minimum rate powers in intermodal competitive situations. Based on this examination, the Commission stated

such powers should be used "sparingly"[27] and "Generally its application has been confined to instances in which we have found that a rate was so low as needlessly to sacrifice a carrier's revenue."[28] And, in *New Automobiles*, the Commission iterated[29] the thought it had earlier expressed in *Seatrain Lines, Inc. v. Akron, C. & Y. Ry.*, 243 I.C.C. 199, 214 (1940):

> . . . it is of interest that the rule of rate making in section 15a has been recently amended so as to require us, in the exercise of our authority to prescribe just and reasonable rates, to "give due consideration, among other factors, to the effect of rates upon the movement of traffic *by the carrier or carriers for which the rates are prescribed* * * *." This admonition is repeated in sections 216(i) and 307(f), containing rules for rate-making relating to motor and water carriers, respectively. The words which have been italicized for emphasis are of particular interest. They were not in either of the bills originally passed by the Senate and the House of Representatives but were added by the committee of conference. Their meaning, supported also by the legislative history, seems to be that no carrier should be required to maintain rates which would be unreasonable, judged by other standards, for the purpose of protecting the traffic of a competitor.

Since in *New Automobiles* the demand by the adversely affected intermodal competitors was that the Commission, in order to preserve inherent advantages,[30] should disapprove rates reduced on an out-of-pocket basis, and this de-

27. 259 I.C.C. at 535.

28. *Idem.* Quoting from Petroleum and Petroleum Products, Calif. to Ariz., 241 I.C.C. 21, 41 (1940).

29. *Id.* at 536-537.

30. *Id.* at 539.

mand had been rejected by the Commission, the court below quite properly felt that *New Automobiles* supports the proposition that normally compensatory rates, which are not detrimental to the proponent carrier's own revenue requirements, should be permitted.

(1) There Is No Merit in the Appellants' Contention That the Court Below Has Erred in Holding That the Philosophy of New Automobiles Applies to Ingot Molds

As the arguments of some of the appellants are understood, they do not deny that the objective of the Congress in enacting Section 15a(3) in 1958 was to admonish the Commission to ahere to the philosophy of *New Automobiles*.[31] But they claim reliance upon it is misplaced because in that case the concern was not with the recognition and preservation of inherent advantages. This contention is patently wrong for two reasons. First, because the motor carriers in *New Automobiles* specifically asked that the reduced rail rates, although compensatory, be ordered increased to preserve their inherent advantages,[32] and second, because the Commission expended considerable effort in comparing the costs of the two comparative modes to determine which had the inherent advantage of lower costs.[33] It is significant that in making this determination. the comparison essentially was of the out-of-pocket costs of the two competing modes.[34]

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31. See S. Rep. No. 1647, *Transportation Act of 1958,* 85th Cong., 2d Sess. at 2, 3 (1958); H. Rep. No. 1922, *Transportation Act of 1958,* 85th Cong., 2d Sess. at 14 (1958).

32. 259 I.C.C. at 530, 539.

33. *Id.* at 506-513, 529, 539.

34. The Commission compared the costs of the railroads with those of other modes to determine "relative fitness of various agencies of transportation," *id.* at 529, and concluded that for distances of beyond 175 miles the railroads were the "fitter agency" *idem.* The com-

But assuming, for argument purposes only, that there may be slight factual differences between *New Automobiles* and *Ingot Molds*, the philosophy of *New Automobiles*, which the Congress sought to preserve by enacting Section 15a(3) condemns *Ingot Molds*. *New Automobiles* stands for the proposition that the Commission shall not deprive the public of reduced rates flowing from intermodal competition, if such reduced pricing is compensatory and not detrimental to the proponent carrier's own revenue requirements. The reduced ingot molds rate passes this test with flying colors because it makes a maximum contribution to the railroads' constant expenses and at the same time affords the shippers two competitive services at equal prices.

While attention is focused upon the analysis of the legislative history, it should be noted the court below also directs attention to statements in the Congressional Debates and Reports which provide additional support for the view that normally the Commission should not interfere with reduced intermodal rates which are compensatory.[35]

(2) The Court Below Was Right in Relying Upon the Rejection by Congress of the Miller-Wadsworth Amendment as Additional Support for Its Position That Normally Compensatory Rates Should Be Permitted

The court below looked beyond *New Automobiles* to determine whether there was anything in the legislative history of the Transportation Act of 1940 which would cast

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parison was of rail out-of-pocket costs and the other mode's fully-distributed cost, *idem*, but this was intended to be a comparison of out-of-pocket costs because the Commission found generally that over the long-range the motor and water carriers' out-of-pocket costs were identical with their fully-distributed costs. *Id.* at 506, 508.

35. 268 F. Supp. at 80-81, A. 27-28.

any doubts upon whether the Commission's *New Automobiles* phiolosphy would carry out the intentions of Congress. Based upon this examination, the court below concluded that the Commission was at that time right, and further the Congress itself, by rejecting proposals for the establishment of "fully-distributed cost" floors, including the Miller-Wadsworth amendment, had evidenced the belief that the public interest would best be served by permitting carriers to reduce rates below "fully-distributed costs," providing they are compensatory.[36]

Appellants argue that the court below has placed too much reliance upon the rejection by Congress of provisions in the earlier versions of the Transportation Act of 1940 which would have established "fully-distributed cost" floors, as a basis for its contention that normally reduced rates exceeding out-of-pocket costs should be permitted.[37]

They contend that the legislative history, including the rejection of such provisions as the Miller-Wadsworth amendment, favors the view that the Commission should be given complete flexibility in adopting standards for preserving inherent advantages. Nothing in what the court below says takes from the Commission the power, in the first instance, to preserve inherent advantages. That right is specifically retained, but the court below quite properly says that the Commission may not, in the light of Congress's disapproval of "fully-distributed cost" floors, arbitrarily impose such floors under the guise of preserving inherent advantages. But this is precisely what the Commission did in *Ingot Molds*.

It is not a little paradoxical that while the Commission here argues that the court below has imposed restraints

36. 268 F. Supp. at 82; A. 31.

37. Briefs of Commission at 30-37; American Trucking Associations at 13-16.

which interfere with its flexibility—which the court below says is not the case—the Commission, in *Ingot Molds,* has adopted an approach which is completely rigid and inflexible. There the Commission finds that low-cost advantage should be preserved by establishing as the floor for one mode's reduced rates the "fully-distributed costs" of another. This floor, which is in no way oriented to the efficient utilization of the nation's transportation resources, in no sense mindful of the "circumstances attending the movement of the traffic by the carrier or carriers to which the rate is applicable," or considerate of the admonition that "rates of a carrier shall not be held up to a particular level to protect the traffic of any other mode of transportation," [38] imposes upon one mode an artificial and rigid floor reflecting the characteristics and nature of the transportation provided by another mode. The claimed right to impose such a rigid floor, diametrically opposed to the most elementary teachings of economics [39] and detrimental to the benefits of competition in the form of lower transportation charges, seems a most curious basis for an argument that the Commission's flexibility is impaired by the holding of the court below.

There is one feature of the rejection of "fully-distributed cost" floors by the Congress in 1940 which should not be overlooked. The Commission itself, through Chairman Eastman, advised the Congress that it was opposed to such floors:

> In our judgment, the provision in question [i.e., the use of fully-distributed cost floors] is not necessary in order that the public at large may enjoy the benefit and economy afforded by each type of transportation. The

38. Section 15a(3) contains these as specific standards; A. 34.
39. See A. 89-95.

> requirement in the rate-making rule that the Commission give due consideration to the effect of rates on the movement of traffic by the carrier or carriers for which the rates are prescribed and also to the need in the public interest of adequate and efficient transportation by such carrier or carriers at the lowest cost consistent with the furnishing of such service, coupled with the admonition in the declaration of policy in section 1 that the provisions of the act be so administered as to recognize and preserve the inherent advantages of each mode of transportation, will afford adequate protection in this respect. If experience should show that further protection is needed, contrary to our expectation, Congress can amend the act, but such a restriction as is now proposed is, we believe, both unnecessary and undesirable.[40]

Later in *New Automobiles,* when specifically confronted with a demand that a "fully-distributed cost" floor be established to preserve inherent advantages, the Commission, relying upon the legislative history of the Transportation Act of 1940, reaffirmed its views taken before the Congress and concluded that if reduced rates were compensatory they afforded all of the protection for inherent advantages which is economically justified.

(3) The Contention of the Appellants That the Interpretation of Section 15a(3) by the Court Below Is Tantamount to the Three Shall-Nots Is Misconceived.

The appellants contend[41] that the interpretation of Section 15a(3) by the court below results in the establish-

40. 86 Cong. Rec. 10191 (1940).

41. Briefs of Commission at 37-40; American Commercial Lines at 23-29.

ment of the three shall-nots[42] doctrine which was rejected by the Congressional committees.

As this Court noted in *New Haven*, the language of Section 15a(3) was the product of compromise.[43] The railroads, the principal victims of the Commission's protective and paternalistic actions, urged the enactment of legislation drafted by the Secretary of Commerce which would have compelled the Commission, in judging the lawfulness of reduced rates, to do so entirely from the standpoint of the proponent mode and without regard to the impact of such reductions upon another mode. By contrast, the other modes suggested rigid rules which would have established the proponent mode's own "fully-distributed costs" as the floor for its reduced rates.[44] While the committees did not spell out their reasons for rejecting the three shall-nots proposal, Senator Lausche, referred to as "one of the knowledgeable members of the committee in the

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42. The "three shall-nots" bill was drafted by the Secretary of Commerce and introduced in 1955 as H.R. 6141, 84th Cong., 2d. Sess. It provided that in determining whether a rate is less than a reasonable minimum, the Commission:

> . . . shall not consider the effect of such charge on the traffic of any other mode of transportation; or the relation of such charge to the charge of any other mode of transportation; or whether such charge is lower than necessary to meet the competition of any other mode of transportation. . . .

This proposal was supported by the railroads. See *Hearings On H.R. 6141 before Subcommittee on Transportation and Communications of House Interstate and Foreign Commerce Committee*, 84th Cong., 2d Sess., at 532, 537, 540, 548 (1956), and New Haven, 372 U.S. at 753.

43. 372 U.S. at 753-755.

44. See, *e.g.*, Statements of John L. Weller and James F. Pinkney, *Hearings on S. 3778 Before the Senate Committee on Interstate and Foreign Commerce*, 85th Cong., 2d Sess., at 26, 79-81 (1958); Statements of John O. Innes and James F. Pinkney, *Hearings on Railroad Problems Before a Subcommittee of the House Committee on Interstate and Foreign Commerce*, 85th Cong., 2d Sess., at 152, 310-322 (1958).

field of transportation,"[45] did make it plain that the extreme positions of the other modes seeking "fully-distributed cost" floors were completely unacceptable. He said, "the proposal which you made, if adopted, would completely negative the purpose and intent of the Congress in 1940 and 1935 when it decided that the inherent advantages of each mode of transportation shall be preserved in the interest of the public."[46]

As this Court in *New Haven* found, the desire of Congress was to "permit each mode to assert its 'inherent advantages whether they be of service or of cost,' " and "to permit the railroads to respond to competition by asserting whatever inherent advantages of cost and service they possess."[47]

There were a great many expressions by Senators and Congressmen that these aims would be accomplished by allowing reduced rates, provided they would be compensatory. For example, Congressman Wolverton, a member of the House Commerce Committee in 1958, who had been one of the Managers of the Transportation Act of 1940, said:

> It seems to me, Mr. Langdon, that there is some merit in the point which you have made, that if each mode of transportation is permitted to have rates not below a compensatory figure so that completion can really exist, I think you are then preserving the rights, the inherent rights of each.[48]

Congressman Allen stated that Section 15a(3):

> . . . is designed to promote healthy rate competition between the different forms of carriage. . . . It would

45. 104 Cong. Rec. 10841 (1958).
46. *Hearings on S. 3778, supra,* n. 44 at 26.
47. 372 U.S. at 756, 757.
48. *Hearings on Railroad Problems, supra,* n. 44 at 409.

give carriers greater free play in establishing reduced rates if those rates are compensatory and do not discriminate unjustly among shippers.

In response to a question whether it would be possible under Section 15a(3) for one type of carrier to lower its rate to such an extent that another carrier would not be able to compete, Congressman O'Hara, another member of the House Commerce Committee, answered:

> I think the language is rather plain and means exactly what it says; that is if that particular mode of transportation has a compensatory rate and it is lower than that of the competitior, the Interstate Commerce Commission would have to allow that competing form of transportation to charge a lower rate. Does that answer the gentleman's question? [49]

Senator Smathers stated:

> . . . we are trying . . . to get the Commission away from a practice it has fallen into in the past five years, where [in] certain of these cases . . . they have said that even though a [proposed] rate would be compensatory, even though it would return a profit, and so on, we [the Commission] are not going to let them lower the rate because in [doing so] they would injure another mode of transportation with the result that we have high prices, for these articles, fixed usually on what would amount in that particular instance to the less competent mode of transportation. So the public gets hurt in that particular situation was our belief. (Brackets added for clarification.) [50]

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49. 104 Cong. Rec. 12524, 12536 (1958).

50. *Hearings on S. 3778, supra,* n. 44 at 111.

Senators Schoeppel and Lausche, both members of the Senate Commerce Committee, likewise indicated that compensatory rates should not be prohibited.[51]

Unlike the three shall-nots, which would have denied power to the Commission in judging the lawfulness of reduced rates to consider their impact upon another mode, the Congressional committees kept intact power in the Commission to outlaw reduced pricing if it constitutes an unfair or destructive competitive practice. As the House Committee Report stated:

> The committee believes that each mode of transportation should have opportunity to make rates reflecting the different inherent advantages each has to offer so that the public may exercise its choice among them, cost and service both considered, in the light of the kind of transportation desire[d]. The committee believes, however, and the national transportation policy is clear, that such ratemaking should be regulated by the Commission to prevent unfair destructive practices on the part of any carrier or group of carriers.[52]

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51. *Id.* at 10, 56. The colloquy between Senator Schoeppel and former Senator Wheeler, who was one of the managers of the Transportation Act of 1940 and who had introduced the Motor Carrier Act of 1935, is particularly significant:

> SENATOR SCHOEPPEL: Senator Wheeler, you are giving us here the congressional or senatorial intent?
>
> MR. WHEELER: That is right.
>
> SENATOR SCHOEPPEL: Of course, all of that was tied to one cardinal factor; namely, that those rates, when they were established, should be compensatory, was it not?
>
> MR. WHEELER: Exactly. As long as they were compensatory, then they could reduce the rates. The water carriers could reduce their rates as long as they were compensatory to take business away, or the motor carriers could reduce their rate to a compensatory level to take business away from the railroads, and the railroads could reduce their rates to meet the competition, as long as their rates were compensatory.

52. H. Rep. No. 1922, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 13-14 (1958).

The Commission therefore has ample power to prevent reduced pricing which constitutes an unfair or destructive competitive practice. While such practices are not defined in the legislative history, the courts have sustained the power of the Commission to disapprove reduced rates, even though compensatory, if they incorporate exclusive dealing arrangements which exclude another mode from competing.[53] The power of the Commission to condemn reduced rates specifically aimed at destroying a competitor has also been sustained, even though there is no contention that such rates are noncompensatory.[54] And it has been held that a reduction, although compensatory, which is harmful or detrimental to the proponent mode's own revenue requirements, can be found unlawful by the Commission.[55] The power to outlaw noncompensatory rates is, of course, well established by the courts[56] and recognized by the Commission.[57]

The appellants, rely upon the colloquy between Commissioner Freas and the Senate Committee,[58] which was referred to by this Court,[59] as support for their contention

53. See New York Central R.R. v. United States, 194 F. Supp. 947, 951 (S.D. N.Y. 1961), aff'd *per curiam*, 368 U.S. 349 (1962).

54. See Luckenbach Steamship Co. v. United States, 179 F. Supp. 605, 612-614 (D. Del. 1959), aff'd *per curiam*, 364 U.S. 280 (1960).

55. See Atlantic Coast Line R.R. v. United States, 209 F. Supp. 157, 159-160 (S. D. Fla. 1962). See also Tractors—T.L. & W.T.L. Territories, to S.W. & W.T.L. Ter., 319 I.C.C. 758, 765 (1963).

56. See Middlewest Motor Freight Bureau v. United States, 234 F. Supp. 151, 153-154 (D. Minn. 1964); Missouri Pac. R.R. v. United States, 203 F. Supp. 629, 635 (E.D. Mo. 1962); New York, N.H. & Hartford R. R. v. United States, 199 F. Supp. 635, 646 (D. Conn. 1961); Boston and Maine R.R. v. United States, 153 F. Supp. 952, 960 (D. Mass. 1957).

57. See Aluminum Ingots, Kansas City, Mo., to Fort Wayne, Ind., 326 I.C.C. 1, 5 (1965).

58. Brief of American Commercial Lines at 27-29.

59. 372 U.S. at 755.

that the rejection of the three-shall-nots condemns the interpretation of the court below and supports the Commission's use of "fully-distributed cost" floors in *Ingot Molds*. If there is any residual persuasion in this colloquy after the explicit Congressional directive to adhere to the philosophy of *New Automobiles*, it is dispelled by Commissioner Freas' own statements. He was Chairman of Division 2 of the Commission, which was first called upon to determine the lawfulness of ingot molds rate. In the Division's Report, the ultimate conclusion was:

> In the circumstances presented, we find for the encouragement of lawful competition and conclude that the proposed rate [ingot molds] is just and reasonable, and, consistent with the Court's [the Supreme Court's] evaluation of Section 15a(3) in the *New Haven case*, not destructively competitive.[60]

And in dissenting to the Commission's report, which found the reduced ingot molds rate unlawful, Commissioner Freas said:

> To limit a proposed reduction in rate to the fully-distributed level of another mode, regardless of the level of the other mode's rate or of other transportation circumstances, is patently anti-competitive. It must be determined whether there is room for reasonable competition. The writer so testified on behalf of the Commission in hearings which ultimately culminated in the passage of Section 15a(3).[61]

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60. 323 I.C.C. at 765, A. 44.

61. 326 I.C.C. at 88; A. 76. Commissioner Tierney, who also dissented, said:

> The majority's action herein, utilizing arbitrarily the fully distributed cost level of the low-cost mode as a floor below which the high-cost mode cannot go in establishing a competitive rate on a compensatory basis, in my opinion is contrary to the legislative history of Section 15a(3) (326 I.C.C. at 91; A. 79-80).

(4) The Legislative Histories of the Transportation Act of 1920 and the Motor Carrier Act of 1935 Sustain the Statutory Interpretation of the Court Below.

The Commission, in its brief, reviews the legislative histories of the Transportation Act of 1920 [62] and the Motor Carrier Act of 1935.[63] While the relevance of these efforts may be questionable, the conclusions reached buttress the statutory interpretation of the court below. For example, the Commission says that the Congress, in enacting the Transportation Act of 1920, indicated that a reduced rail rate, to meet water competition, should only be permitted if it would "cover and more than cover the extra expenses in handling the traffic to which it applies.[64] This is simply another way of saying that the reduced rate will be lawful if it exceeds the out-of-pocket expense of providing the service. This is precisely the interpretation of Section 15a(3) by the court below, and therefore the legislative history of the Transportation Act of 1920, to the extent relevant, supports that interpretation.

Turning to the legislative history of the Motor Carrier Act of 1935, the Commission's conclusion regarding its significance in the area of preserving inherent advantages is found on page 30 of its Brief. There the Commission says:

> Similarly, the Committee changed the rate-making section to refer to "inherent advantages" in order to "require the Commission to fix truck rates on a basis that, so far as possible, reflect the costs and advantages of motor service . . ."[65] This purpose of the phrase

62. 41 Stat. 456-500; Brief of Commission at 24-27.
63. 49 Stat. 543-567; Brief of Commission at 27-30.
64. Brief of Commission at 25.
65. 79 Cong. Rec. 5656 (1935).

> received a new impetus in the Transportation Act of 1940, . . . when for the first time it applied to all modes of transportation.

This argument of the Commission here, provides an additional basis for the position of the court below, that Congress, where expressing a concern with the preservation of inherent advantages, has indicated that from the standpoint of costs, the lawfulness of reduced rates should be judged with the proponent mode's own costs in mind. Since this is so, it follows that normally inherent advantages will be preserved if the reduced pricing exceeds such mode's own out-of-pocket cost level. To require a reduction, as the Commission did in *Ingot Molds,* to reflect the "fully-distributed cost" of a mode other than the proponent categorically contradicts the Commission's arguments to this Court respecting the legislative histories of the Motor Carrier Act of 1935 and the Transportation Act of 1940.

The legislative histories of the several Congressional enactments concerned with intermodal competitve ratemaking are very extensive and contain cross currents and views which may be somewhat difficult to reconcile, but their main theme stands out boldly. The desire of the Congress has been to give each mode freedom to respond to the urgings of competition by reducing the prices of its services to reflect its own cost characteristics and thus pass along the benefits of the resulting lower transportation charges to the public. The one overall controlling guideline is the expressed intention of Congress that by enacting Section 15a(3) the philosophy of *New Automobiles* would be imple-

mented.[66] As explained before, *supra*, 16 to 20, the interpretation of the court below is fully consistent with the philosophy of *New Automobiles*, and, what is of at least equal importance from the standpoint of the instant litigation, the Commission's conclusion condemning the ingot molds rate is patently incompatible with that philosophy and is therefore, as the court below held, not in accordance with law.

B. The Court Below Was Right in Holding That the Commission's Efforts to Recognize and Preserve Inherent Advantages Lack a Rational Basis and Therefore Are Arbitrary

None of the Appellants questions the soundness of the proposition stated by the court below—that if the Commission's efforts to recognize and preserve inherent advantages lack a rational basis they are arbitrary within the meaning of the Administrative Procedure Act, and should be set aside,[67] but the conclusion of the court [68]

66. S. Rep. No. 1647, *Transportation Act of 1958*, 85th Cong., 2d Sess. (1958). The Senate Committee, in adopting the views of its subcommittee, stated at page 3:

> The subcommittee wishes to affirm the interpretation of the Commission given in the Automobile case epitomized in the words quoted above. The subcommittee therefore believes it necessary to amend the act only so as, in effect, to admonish the Commission to be consistent in following the policy enunciated in the Automobile case thus assuring reasonable freedom in the making of competitive rates. * * *
>
> The subcommittee anticipates that the broad effect of this amendment will be to encourage competition between the different modes of transportation to the benefit of the shipping public. * * *

The House Committee Report is to the same effect. H. Rep. No. 1922, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 14-15 (1958).

67. 268 F. Supp. at 75—quoting Section 10(b) of the Administrative Procedure Act and supporting cases, A. 16.

68. *Idem.*

that the rational basis does not exist is disputed.[69]

This Court, in *New Haven,* left unresolved the questions of how inherent advantages should be recognized and preserved, as required by the National Transportation Policy, which is an integral part of Section 15a(3).[70] The initial resolution of these questions was left to the Commission's judgment. Implicit in this assignment was the thought that the Commission would make a thorough and careful study of the matter and spell out in detail, and with precision, the reasons and justifications for its conclusions. Both in view of what this Court had done in *New Haven* and the importance of the questions to the transportation industry, *Ingot Molds*—which the Commission recognized was a proper vehicle to resolve the questions[71] —far more than the ordinary case, demanded a well articulated, logical and rational basis for the determinations reached. It is not there. This is made plain first, by the decision of the court below; and second, by the efforts of the appellants to fill the vacuum by a late conceived theory, which is unsound, and was neither discussed by the Commission nor used as a basis for its decision.

Since the National Transportation Policy, in addition to requiring the Commission to recognize and preserve inherent advantages, also instructs the agency to "foster sound economic conditions in transportation and among the several carriers," the railroads, in defending the ingot molds rate, presented testimony describing the economic principles applicable to price reductions in competitive situations. This testimony, which was not refuted, demonstrates that adherence to these principles will insure the

69. Briefs of Commission at 40-50; American Commercial Lines at 39-51; American Trucking Associations at 20-24; and American Waterways Operators at 12-16.

70. 372 U.S. at 760-761.

71. 326 I.C.C. at 80; A. 65.

recognition and preservation of the inherent advantages of the several modes of transportation and will result in the most efficient utilization of the nation's transportation resources.[72]

Briefly, it is elementary economics that in determining the wisdom of making a pricing reduction of an individual service to respond to competition, the only relevant cost is incremental cost or, as that term is used here, out-of-pocket cost. This is the added expense incurred in producing the particular service. With this cost as the floor, the price is established upwards from it so that the excess of revenues above such cost is maximized. The achievement of this objective depends primarily upon demand considerations. If the demand for the particular service is strong, as it will be if attractive alternative competitive services are not present, a price considerably above the out-of-pocket cost floor can be charged. But where competition is intense and attractive alternate services exist, a price fairly close to the out-of-pocket floor must be established to generate traffic. Where the aggregate revenues above the out-of-pocket cost floor are maximum because the price is properly responsive to the competitive situation, the enterprise can do no better.[73]

It is the revenues above the out-of-pocket cost floor which are used to meet the enterprise's constant expenses. Thus, the recovery of the total constant expenses is dependent upon the application of the principles just described.

It is a characteristic of the railroad industry that many individual services which make substantial contributions to the railroads' constant expenses are those which have rates quite close to the out-of-pocket cost level. Typi-

72. This testimony was offered by four distinguished economists and is set forth in full in the appendix, A. 81-160.

73. A. 86-87.

cal examples are bulk commodities, such as coal and iron ore, which move in large volumes.[74]

Fully-distributed cost related to a particular item of traffic, as explained before,[75] is a combination of out-of-pocket expenses plus an arbitrary assignment of a portion of the constant expenses. Because of this, it cannot be used intelligently as a floor for reduced competitive pricing. Such a floor is artificially inflated and, in a large number of instances, will rule out many rates below it which must be established at such levels to effectively compete. These rates, by attracting or holding business, would produce revenues above the expenses of providing the service, *i.e.*, the out-of-pocket costs and, therefore, would make contributions toward the constant expenses. Thus, the use of "fully-distributed cost" floors in competitive situations will destroy opportunities to recover constant expenses.[76]

Where the concern is with the determination of which of two competitive modes is the more efficient, or has the advantage of lower costs, in providing a particular competitive service, a comparison of out-of-pocket costs is the only one that may be sensibly made, since such costs represent the expenses each mode actually incurs in performing that service.[77] For such purpose a comparison of "fully-distributed costs" cannot be justified.

While the recognition of which of two modes has the inherent advantage of lower costs may have importance, of more crucial concern is the preservation of low-cost advantage. From the standpoint of elementary and fundamental economics, the inherent advantage of lower costs, or su-

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74. A. 141.
75. *Supra*, at 5.
76. A. 89-98, 111-115, 123-129, 134-136, 147-148.
77. A. 114, 134-135.

perior efficiency, is preserved if the out-of-pocket costs of the proponent mode are established as the floor for—not the level of—reduced carrier pricing. Such a floor permits the carrier to establish pricing which will be properly responsive to demand and competitive circumstances and at the same time prevents below-cost pricing which is destructive to the proponent and harmful to the competitor. Thus, the out-of-pocket floor permits each mode to reflect its own cost characteristics and to thereby assert whatever advantages of low cost it may possess. Further, and more important from the standpoint of the public interest, such a floor promotes the most efficient use of the nation's transportation resources and affords the shipping public the lowest transportation rates commensurate with reasonable carrier prosperity.[78]

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78. That these economic principles are widely held and generally regarded as both elementary and fundamental has ample support. For example, the ANNUAL REPORT OF THE COUNCIL OF ECONOMIC ADVISERS (1966) in reporting to the President said:

> For maximum economic efficiency, rates should be related to costs, but not to an arbitrary allocation of costs. Railroads and pipelines require large, indivisible capital inputs such as rights-of-way and terminals. These indivisibilities result in relatively high fixed costs, which, if allocated over each traffic unit on an arbitrary basis, result in average costs unrelated to the variable expenses of additional traffic. These average costs do not and cannot serve as a rigid basis for rate making.
>
> "Cost-oriented rates" in the true economic sense are related to the economist's concept of marginal cost—the increase in total expenses as a result of carrying additional ton-miles of traffic. In order to ensure efficiency, marginal, rather than average, cost should be the principal regulatory criterion in applications for rate reductions (*Id.* at 126).

In the Economic Report of the President, transmitted to the Congress in January 1966, the recommendations of the Council are endorsed and characterized at page 12 as guideposts for noninflationary wage and price behavior.

The views of the Council are virtually identical to those earlier expressed in the REPORT OF THE ROYAL COMMISSION ON CANADA'S ECONOMIC PROSPECTS (1957):

Application of the economic principles just discussed to the ingot molds rate compels the conclusion that the Commission should have approved it. The Commission found that for handling this particular traffic "The railroads' out-of-pocket costs are lower than the barge-motor lines variable costs." [79] In view of this finding, the railroads, without incurring a loss, have the ability to price their service at lower levels than the barge-truck route. And with respect to such ability, what this Court said in *Schaffer Transp. Co. v. United States*, 355 U.S. 83, has special significance:

> The ability of one mode of transportation to operate with a rate lower than competing types of transportation is precisely the sort of "inherent advantage" that the congressional policy requires the Commission to recognize. (*Id.* at 91) [80]

Actually, the railroads have not exploited their advantage since they have not undercut the barge-truck price but merely equaled it, thereby giving the shipper a choice of two competitive services at the same price. The ingot molds rate is not detrimental to the railroads' own revenue needs, but is in fact constructive because it provides increased contributions to their constant costs.[81] And

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Of course, any traffic which meets its long-run out-of-pocket costs and makes some contribution to common overheads, no matter how small, should be carried by the carrier concerned; in this way overheads on the remaining traffic are reduced, all shippers are better off, and the most efficient use of transport resources is promoted (*Id.* at 274).

79. 326 I.C.C. at 84; A. 71.

80. The reports of the Senate House Committees in 1958 cited this case and particular quotation with approval in their comments recommending the adoption of Section 15a(3). S. Rep. No. 1647, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 3 (1958); H. Rep. No. 1922, *Transportation Act of 1958*, 85th Cong., 2d Sess. at 13-15 (1958).

81. 323 I.C.C. at 763-764; A. 42.

the approval of the rate would leave intact, and therefore preserve, whatever inherent advantage is possessed by the barge-truck route. Such service is still completely free to adjust its price to reflect its own cost characteristics.[82]

While Division 2 notes in passing that the testimony relating to the economic principles was before it,[83] at no point in its report is there any adequate explanation as to why the principles should not be followed. The only stated basis for ignoring the economic principles is that ". . . we [the Division] recognize the existence of constant costs. The use of out-of-pocket or incremental costs advanced here by . . . [the railroads] ignores them."[84] This conclusion of Division 2 totally disregards and repudiates the teaching of the economic principles that the out-of-pocket cost floor, with pricing established above it which is responsive to demand considerations, is not only the best way to meet constant expenses but, in virtually every instance, the only way. The Commission, in its Report, does not even mention the economic principles.

As explained by the court below, the Commission "was not bound to accept" the economic testimony, but its presence did "make it necessary for the Commission to set forth adequate reasons to support its own approach,"[85] which was completely to the contrary. See *Chicago Junction* case, 264 U.S. 258, 265; *Schaffer Transp. Co. v. United States*, 355 U.S. 83, 91-92.

The court below quotes in full the reasons given by the Commission for using a comparison of "fully-distributed costs" for the recognition of low-cost advantage,[86] and ex-

82. 323 I.C.C. at 764; A. 42-43.
83. 323 I.C.C. at 761; A. 39-40.
84. 323 I.C.C. at 763; A. 41.
85. 268 F. Supp. at 77; A. 20.
86. 268 F. Supp. at 76; A. 18-19.

plains why they are completely inadequate. The unanswered question, as the court below says, is why one mode which has lower out-of-pocket costs in performing a particular service, assuming these costs include all of the expenses of providing that service, is not more efficient than another mode whose out-of-pocket costs of furnishing a comparable service are higher.

The Commission's reference to the *Southern Grain* case [87] for using "fully-distributed cost" comparisons to determine the existence of inherent advantages is wholly without logic, for in that case the Commission concluded that where water carriage is unregulated—which the court below might have added is the predominant situation [88]—reduced rail rates to meet such competition should be permitted if they exceed "the proponent carrier's out-of-pocket costs." [89] Unregulated water transportation operates lawfully and comprises an important part of the nation's transportation system, and therefore, if such policy is economically sound where railroads are competing with unregulated water carriers, it should be equally so where the competition is regulated. To reach a different conclusion requires an assumption that because the competition is regulated its traffic is entitled to artificial protection from otherwise fair competition. But such an assumption would be without basis in view of what this Court said in *New Haven*:

> The mood of Congress was perhaps best summarized by Senator Smathers when he said:

87. 268 F. Supp. at 77; A. 21.

88. 80TH ANNUAL REPORT OF INTERSTATE COMMERCE COMMISSION at 147 (1967). Almost 90 percent of the intercity ton-miles by water carriage are not federally regulated. For motor carriage the nonregulated figure is 65 percent.

89. 268 F. Supp. at 77; A. 21.

> "[W]e are going to eliminate some of the paternalism which has heretofore existed in the minds of the Interstate Commerce Commission. I think we will breathe into our whole system of transportation some new competition, which of course is needed, because the public and the consumer will benefit therefrom." [90]

The appellants also argue that the court below erred in holding that the required rationale was not supplied by the Commission's reliance upon its own earlier cases.[91] While it is well established that the Commission may look to its earlier cases as a basis for decision, this may only be properly done if such cases themselves contain an adequate rationale and represent a consistently applied standard. See *T.I.M.E. v. United States*, 359 U.S. 464, 476.[92] In the opinion of the court below, there are listed several Commission cases in which the "fully-distributed cost" approach of *Ingot Molds* was not used, and rates which were reduced because of intermodal competition were approved on the basis they exceeded the proponent mode's own out-of-pocket costs.[93] In addition to the cases listed and the one quoted from, the court below could have included a very large number of cases to the same effect. A typical example would be *Aluminum From Kansas City to Illinois and Wisconsin*, 321 I.C.C. 432 (1963), where a motor carrier

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90. 372 U.S. at 757.

91. See *e.g.*, briefs of American Commercial Lines at 43; American Trucking Associations at 21.

92. See also County of Marin v. United States, 356 U.S. 412, 420; New York Central Railroad v. United States, 267 F. Supp. 619, 624-625 (S.D. N.Y. 1967). Cases cited by appellants for the proposition that the Commission correctly relied upon its earlier decisions, such as Simpson v. United States, 200 F. Supp. 372 (S.D. Iowa 1961) and Nowinsky Trucking Company v. United States, 195 F. Supp. 748 (W.D. Wis. 1961) are not in point because each assumes that the earlier decisions relied upon supply the required rational basis. 200 F. Supp. at 377 and 195 F. Supp. at 751.

93. 268 F. Supp. at 78; A. 22.

reduced its rate on aluminum ingots to 61.5 cents, thus equalizing the rail rate. The railroads protested this reduction claiming it was noncompensatory. Finding the reduced rate exceeded the motor carrier's out-of-pocket costs by a mere 2.6 cents, the Commission approved it saying:

> The proposed rate now appears to be reasonably compensatory. It is a matter of record that a rate on the level of the competitive rail rate, is the highest the shipper will pay for motor carrier service. In these circumstances the proposal is deemed justified. *Id.* at 433.

A mere reading of the cases cited by the Commission in its Report will make it abundantly plain that none contains a rationale for using a comparison of "fully-distributed costs" to determine the existence of low-cost advantage.[94]

Some of the appellants take the position[95] that the Commission's reference to *New Haven* supplies a rational basis for comparing "fully-distributed costs" to determine low-cost advantage. This Court did say in *New Haven* that the problem of how inherent advantages should be recognized and preserved in a situation like *Ingot Molds* led to the incorporation of the National Transportation

94. 326 I.C.C. at 83-84; A. 70. [illegible] Electric Cable & Wire, Worcester, Mass., to Houston, Tex., [illegible] I.C.C. 390 (1963), is a three-page report and order which is totally devoid of any discussion as to why "fully-distributed costs" should be the measure rather than incremental costs. Plastics From Texas to the East, 319 I.C.C. 379 (1963) is similarly devoid of such discussion. In Frozen Juice & Fruit From Florida to the North, 319 I.C.C. 577 (1963), the Commission was unable to determine which mode had the lower costs; and in Candy & Confectionery From N.J., N.Y. & Pa. to Tex., 321 I.C.C. 154 (1963), there was no real concern with the measure of low-cost advantage. And what is most significant in all four of these cases, the ultimate finding was that the reduced rail rates were lawful.

95. Briefs of American Commercial Lines at 46-47; American Trucking Associations at 17-20.

Policy in Section 15a(3).[96] But, as noted by the court below, in *New Haven,* this Court in the clearest language held that the problem was not before it and that it was neither addressing itself to the problem nor recommending a solution. Rather, the solution was initially to come from the Commission after being considered in an appropriate proceeding.[97] The court below therefore correctly held that the Commission's looking to *New Haven* for support was futile.[98]

One of the most astounding features of the Commission's Report is its treatment of the second aspect of the inherent advantages problem. Certainly of at least equal importance to the recognition of which mode has the inherent advantage of lower costs is the means taken to preserve such advantage with whatever mode may possess it. The Commission disposes of this in a single, very short paragraph containing: first, a naked conclusion; second, a complete *non sequitur,* and third, citations to cases of this Court which have no relevance whatsoever to the problem and were decided before the enactment of Section 15a(3).[99] Without the support of any economic principle

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96. 372 U.S. at 758-759.

97. 372 U.S. at 749-750, 760.

98. 268 F. Supp. at 78; A. 22-23.

99. The court below, 268 F. Supp. at 79; A. 24, quotes the paragraph which reads:

> In short, by reducing its rate below the level of the barge-truck full costs, the respondent railroads have unlawfully impinged upon the ability of the barge-truck mode competitively to assert its inherent cost advantage. This action we cannot approve. To hold otherwise we would deprive barges from asserting an inherent cost advantage and we would deprive shippers of cheaper water transportation. *Cf.* Interstate Commerce Commission v. Mechling, 330 U.S. 567, 575-579, 67 S.Ct. 894, 91 L.Ed. 1102 (1947); Dixie Carriers, Inc. v. United States, 351 U.S. 56, 76 S.Ct. 578, 100 L.Ed. 934 (1956).

or theory and without any explanation whatsoever of why it is doing so, the Commission says that the inherent advantage should be preserved by establishing, as the floor for the proponent mode's reduced pricing, the "fully-distributed cost" level of another mode.[100] It is not surprising that Commissioner Freas, in dissenting, was persuaded to say:

> In light of the arbitrary aspects of fully distributed costs, I find it hard to square the majority's cavalier acceptance of those costs as a pricing floor with more relaxed and, to an extent, incremental, standards of other formulas.[101]

The language used by the court below in holding that a rationale is wholly lacking for this conclusion of the Commission speaks tersely and convincingly. There would appear to be no reason to argue the point further.[102]

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100. 326 I.C.C. at 85; A. 71.

101. 326 I.C.C. at 87; A. 74.

102. Throughout the briefs of the corporate appellants, there are allegations to the effect that the opinion of the court below will enable the railroads to destroy their intermodal competitors, *e.g.*, Briefs of American Commercial Lines, at 16, 19, 57, 59; American Trucking Associations, at 7; and American Waterways Operators at 17-18, and at one point the extravagant claim is made that the railroads "have deliberately selected a rule of law which would let them destroy low-cost water carriers rather than compete with them." A short answer to these false and misleading allegations is the total absence of any findings by the Commission that the ingot molds reduction is predatory, or maliciously conceived.

A further answer is, although the majority of rail rates are below fully-distributed cost levels, such pricing has in no way impaired the phenomenal growth of the barge and motor truck carriers. There was incontroverted evidence to this effect before the Commission in Ingot Molds. Exhibit No. 42 [not printed in the appendix] shows since 1958, the date of the enactment of Section 15a(3), intercity truck traffic has increased over 35 percent, and barge traffic over 27 percent, while rail traffic has had only a modest increase of 14 percent. These figures have particular significance in view of the earlier claim made in 1933 by Mississippi Valley Barge Co.—one of the more important appellants here—that certain reduced rail rates "high enough

(1) The Efforts of the Appellants to Supply the Rational Basis Lacking in the Commission's Reports Must Fail

A side by side reading of the Report of the Commission and the briefs of the appellants on the issue of whether the Report contains a rational basis for the determinations reached, leaves a strong feeling that the appellants themselves lack confidence in the Commission's efforts and that therefore they must do what the Commission could not do—supply a rationale. Each of the briefs contains a great deal of argument, none of which was articulated or relied upon by the Commission in its Report. The chief thrust of these attempted *post hoc* rationalizations is spelled out in the Commission's brief which goes to great lengths to show that a comparison of "fully-distributed costs" is the only way to give recognition to the fact that the water carriers and motor carriers have the natural advantage of access to Government supplied rights-of-way at little or no cost, and by contrast the railroads must pay for their rights-of-way out of their own pockets.[103] The other appellants advance the same proposition.[104]

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to pay more than the cost of service" were unlawful. Mississippi Valley Barge Co., in support of its claim said ". . . it is fighting for its life, and that the effect of the new competition will be to drive it out of business . . . [and] if respondents succeed, the barge lines will be dealt a staggering blow." These contentions were readily disposed of by this Court in Mississippi Valley Barge Co. v. United States, 292 U.S. 282. In sustaining the Commission's order which had found rail reduced rates lawful, this Court held that the railroads should not "be required to maintain a rate that is too high for fear that through the change they may cut into the profits of carriers by water" in the absence of a showing that the reductions were "in circumstances of wanton or malicious injury." (*Id.* at 288, 289)

103. Brief of Commission at 46-50.

104. Briefs of American Commercial Lines at 44-48; American Waterways Operators at 12-14.

Nowhere in either of the Reports of Division 2 or the Commission is there a single word having anything to do with whether Government supplied rights-of-way for water and motor carriers constitute an inherent or natural advantage. And this is equally so as to whether "fully-distributed costs" should be used to measure the windfall. In view of this, these late supplied rationalizations cannot aid the appellants here. As this Court said in *Burlington Truck Lines v. United States,* 371 U.S. 156, 168-169:

> The courts may not accept appellate counsel's *post hoc* rationalizations for agency action; *Chenery* requires that an agency's discretionary order be upheld, if at all, on the same basis articulated in the order by the agency itself. . . .

But assuming *arguendo* only, these attempted rationalizations can be properly advanced by the appellants here, they are nevertheless in substance fatally deficient.

The costs of Government in supplying waterways, canals and navigation improvements, which are made available without any user charges to the water carriers for the pursuit of their commercial activities; and the costs of Government in supplying the magnificent national highway system abundantly used by the motor carriers, which are not covered by adequate user charges, in no way are included or reflected in the water carrier or motor carrier costs when computed by the Commission's applicable formulas. No such costs were assessed against the barge-truck route in *Ingot Molds.* This is true regardless of whether the costs are computed on an out-of-pocket or fully-distributed basis.

By contrast the railroads' out-of-pocket expenses, as computed by Rail Form A—as was done in *Ingot Molds*—include all of the right-of-way expenses which are regarded

as being incurred by the particular service being costed, for example, they include large amounts of the expenses occasioned by maintenance and construction of roadway property plus 50 percent of the return on the depreciated value of all roadway property.[105] This being true, a comparison of the two modes' out-of-pocket costs to determine low-cost advantage gives full cognizance to the fact that water motor carriers have the use of free roadways and that the railroads have to pay for theirs.[106]

But more importantly, if the proponent mode's own cost characteristics are to determine from the cost standpoint the lawfulness of its rate reductions, it follows that the establishment of the proponent mode's out-of-pocket costs as the floor will both recognize and preserve the advantage the water and motor carriers enjoy from the availability of Government supplied rights-of-way. This must be so because the costs of such facilities are not included in these modes' out-of-pocket costs. And the corollary is equally true. The use of the railroads' out-of-pocket costs, which include the variable portion of roadway expenses, as a floor for reduced rail rates, will give recognition to the fact that the railroads have the disability of paying for their rights-of-way.

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105. See EXPLANATION OF RAIL COST FINDING PROCEDURES AND PRINCIPLES RELATING TO THE USE OF COSTS—I.C.C. COST FINDING SECTION STATEMENT No. 7-63 at 58, 60, 86 (1963). The costs, as computed by Rail Form A in Ingot Molds, are not in dispute here nor were they in the court below.

106. The Economic testimony made the point that any comparison of "fully-distributed costs" to determine low-cost advantage would be unsound because such comparison does not give recognition to the fact that included in the costs of furnishing barge and truck services are the costs borne by the Gover..ment. See A. 89-91; 134-135. The existence of this situation likewise distorts in favor of the barge and motor carriers a comparison of out-of-pocket costs.

It must be obvious that the position of the appellants here would superimpose upon an injustice, *i.e.*—the supplying of rights-of-way by the Government to the water and motor carriers without adequate reimbursement—the added unfairness of an anticompetitive restraint against the railroads in the form of uneconomic and artificial rate floors. While this is bad enough from the standpoint of the railroads, which would be denied the right to compete on a fair and equitable basis, and in conformity with the intentions of the Congress, it is still worse for the public, which would be deprived of the benefits of competition in the form of lower transportation charges.[107]

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107. It is significant that since the passage of Section 15a(3) in 1958, which has given the railroads a measure of pricing freedom, the level of rail freight charges has been reduced some 13 percent comparing 1965 and 1958.

V.

CONCLUSION AND RELIEF REQUESTED

For the reasons stated more fully above, it is most respectfully submitted that this Court should affirm the judgment of the court below which set aside the Report and Order of the Interstate Commerce Commission in *Ingot Molds, Pa. to Steelton, Ky.*, 376 I.C.C. 77 (1965) and enjoined the Commission from enforcing it.

Respectfully submitted,

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PROOF OF SERVICE

I, CARL HELMETAG, JR., one of the attorneys for the the Railroad appellees herein, and a member of the Bar of this Court, hereby certify that on the 10th day of April, 1968, I served copies of the Brief for Railroad Appellees on counsel for all the parties to this action as follows:

1. On the United States, by mailing copies in duly addressed envelopes:

A. With first-class postage prepaid to the Honorable Erwin N. Griswold, Solicitor General, Honorable Ramsey Clark, Attorney General, Honorable Donald F. Turner, Assistant Attorney General, Lionel Kestenbaum, Esq., and Richard Haddad, Esq., Attorneys, Department of Justice, Washington, D. C. 20530.

B. With air mail postage prepaid to the Honorable Ernest W. Rivers, United States Attorney and Honorable William B. Martin, Assistant United States Attorney, Federal Building, Room 211, Louisville, Ky. 40201.

2. On the appellant Interstate Commerce Commission, by mailing copies in duly addressed envelopes, with first-class postage prepaid to its attorneys, Honorable Robert W. Ginnane, General Counsel, Honorable Fritz R. Kahn, Associate General Counsel, Honorable Leonard S. Goodman, Associate General Counsel, Washington, D. C. 20423.

3. On the separate appellants herein, by mailing copies in duly addressed envelopes:

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C. Ames, Jr., Esq., 529 Transportation Building, Washington, D. C. 20006, attorneys for Mississippi Valley Barge Lines, et al.

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